

# **Chapter 5—Overview of the Audit Process**

## **1—existence or occurrence**

**The existence or occurrence assertion deals with whether assets or liabilities exist at a given date and whether recorded transactions have occurred.**

**A misrepresentation would occur if fictitious sales were recorded. A main concern here relates to overstatement of financial statement elements.**

## **2—completeness**

**Completeness assertions deal with whether all transactions and accounts that should be in the financial statements are included.**

**Our focus here relates to possible understatement of financial statement elements.**

### **3—rights and obligations**

**This assertion deals with whether assets are the rights of the entity and liabilities are the obligations of the entity.**

### **4—valuation or allocation**

**This assertion is focused on whether asset, liability, revenue, and expense accounts are stated at appropriate amounts. Keep in mind that:**

- any amount must be determined in accordance with GAAP**

- any amount must be mathematically correct**

## **5—presentation and disclosure**

**This assertion addresses whether specific elements of the financial statements are properly classified, described, and disclosed**

### **Audit Risk**

**The auditor must consider audit risk not only for each account balance and transaction class but for each assertion relevant to material account balances or transaction classes.**

**Auditors usually describe audit risk as function of three components contained in the audit risk model.**

## **Inherent risk**

**One good example of inherent risk factors are economic and competitiveness forces that can affect an entity's earnings, cash flows, and survival.**

## **Control risk**

**In today's climate, information processing controls are becoming increasingly important. Moreover, auditors are learning to place more emphasis on those controls that reduce the opportunity to commit fraud.**

## **Audit Evidence Decisions**

**1—which audit procedures to use**

**Examples:**

**--physical inventory counts,  
comparisons of canceled checks with  
cash disbursements, shipping document  
details**

## **Persuasiveness of Evidence**

**1—competence**

**--refers to the degree to which evidence  
is believable**

**--competence deals only with the audit  
procedures selected**

**The six characteristics of competent  
evidence are:**

## **1—relevance**

### **Example:**

**An auditor is concerned a client is failing to bill customers for shipments. Compare a sample of shipping documents to related duplicate sales invoices.**

## **4—auditor's direct knowledge**

**It is more competent than evidence obtained indirectly.**

## **5—qualifications of those providing the information**

### **Example**

**Confirmations from attorneys and bankers**

## **6—degree of objectivity**

**--Objective evidence is more reliable. An example is A/R confirmations.**

## **2—sufficiency**

**b) the particular items tested affect sufficiency**

**e.g., items with large \$ values are considered sufficient that are representative of the population**

## **Audit Procedures Classification**

**1. procedures to obtain an understanding**

**--field work standard #2 requires an understanding of the client's internal controls**

**--the auditor may inquire of management about internal controls**



**--auditors inspect client accounting manuals and flowcharts**

**--observations of client activities and operations also yield knowledge of IC**

**--design of IC is the auditor's concern**

## **2. tests of controls**

**--done to yield evidence concerning the effectiveness of the design and operation of the client's IC**

**--includes inquiries of employers as to actually doing control procedures**

### **3. substantive tests**

**These include:**

**--analytical procedures**

**--tests of details of transactions—review support for individual debits and credits posted to an account**

**--tests of details of balances—the auditor looks at support for an ending balance**

**e.g., cash account > bank statements, deposit slips, canceled checks**